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Conference Summary

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Chairman
4th District, Oklahoma

Taxpayer Refund and Relief Act

H.R. 2488

Committee on Ways & Means
H.Rept. 106-289

Legislative History:

The House passed H.R. 2488 (*H.Rept. 106-238*) by a vote of 223-208 on July 22, 1999. The Senate approved its version (S. 1249; *S.Rept. 106-120*) by a vote of 57-43 on July 30. The House adopted the conference report to H.R. 2488 by a vote of 221-206 on August 5. The Senate passed the conference agreement by a vote of 50-49 the same day. President Clinton vetoed the measure on September 23, 1999.

Highlights:

H.R. 2488 provides $792 billion in broad-based tax relief over 10 years. Specific details of the conference agreement are outlined below.

Broad-Based Tax Relief. The measure reduces all individual income tax rates by one percentage point to provide $283 billion in tax relief. Specifically, the bill reduces (1) the 15 percent rate to 14 percent (a 6.7 percent reduction); (2) the 28 percent rate to 27 percent (a 3.6 percent reduction); (3) the 31 percent rate to 30 percent (a 3.2 percent reduction); (4) the 36 percent rate to 35 percent (a 2.8 percent reduction); and (5) the 39.6 percent rate to 38.6 percent (a 2.5 percent reduction).

The bill reduces the 15 percent income tax rate to 14.5 percent in 2001 and to 14 percent in 2003. The bill reduces all other rates by one percentage point in 2005. The measure also expands the new 14 percent tax bracket for single and head of household returns by $3,000 in 2006.

Beginning in 2002, the tax reductions outlined above are contingent on there being no increase in interest outlays for total U.S. federal government debt (*i.e.*, public and trust fund debt). If interest outlays increase (if total debt increases), the conference agreement delays the next phase of the tax reductions for one year.

Marriage Penalty. H.R. 2488 provides $117 billion in tax relief by reducing the impact of the "marriage penalty." Specifically, the bill (1) increases the standard deduction for married couples to twice that of a single person; and (2) increases the new 14 percent tax bracket to twice that of singles beginning in 2005, phased in over four years; and (3) increases by $2,000 the amount a joint-filing couple may earn before their earned income tax credit benefits begin to phase out, beginning in 2006.

Education Tax Relief. The bill provides approximately $15 billion in tax relief through several education tax initiatives. Specifically, it (1) expands the acceptable use of tax-free expenditures from education savings accounts (ESAs) to include elementary and secondary school expenses; (2) increases to $2,000 annually (from $500 under current law) the maximum amount of contributions to ESAs; (3) allows tax-free withdrawals from qualified tuition plans maintained by private educational institutions (state-sponsored institutions may already participate in qualified tuition plans); (4) includes an initiative to help finance local public school construction; (5) extends the exclusion for employer-provided tuition assistance through 2003; and (6) eliminates the 60-month limitation on student loan interest deductions.

Pension Reform. H.R. 2488 includes measures to reform pensions and enhance retirement security, providing $14.9 billion in tax relief. Specifically, the bill (1) increases portability of pensions so employees may "roll over" plans from one job to the next; (2) provides additional salary "catch-up" contributions for workers over age 50 (*i.e.*, these individuals may deposit additional amounts into certain retirement accounts); (3) accelerates vesting requirements for employer matching contributions; (4) increases contribution and benefit limits in defined contribution and benefit plans; and (5) simplifies the pension system to help businesses offer or improve their pension plans.

Capital Gains Tax Relief. The measure reduces the individual capital gains tax rates from 20 percent to 18 percent and from 10 percent to eight percent (for taxpayers in the 15 percent individual income tax bracket). The rate reduction is effective retroactively to January 1, 1999. Beginning January 1, 2000, capital gains are indexed to inflation. In addition, the bill reduces the 25 percent capital gains rate for depreciable real estate held for more than one year to 23 percent effective retroactively to January 1, 1999. These measures provide approximately $35 billion in tax relief.

Estate and Gift Tax. The bill provides $65.6 billion in tax relief by gradually eliminating the estate, gift, and generation-skipping taxes over a 10-year period.

Health Care. H.R. 2488 includes measures to make health care and long-term care more affordable and accessible and provides $43.8 billion in tax relief. Specifically, it (1) provides a 100 percent deduction for health insurance premiums and long-term care insurance premiums; (2) provides an additional exemption (currently $2,750) for individuals who care for elderly family members at home; (3) allows employers to offer long-term care insurance in "cafeteria" plans; and (4) expands the dependent care credit.

Renewal Communities. The measure authorizes the HUD Secretary to designate 20 "renewal communities" in both urban and rural areas, allowing them to qualify for special tax incentives to create jobs, stimulate investment, and assist families in impoverished neighborhoods. These measures will provide approximately $2 billion in tax relief.

Small Business Tax Relief. The bill (1) increases the deduction for health insurance of self-employed individuals to 100 percent beginning in 2000; (2) increases the small business equipment expense deduction to $30,000 annually beginning in 2000; (3) repeals the temporary 0.2 percent FUTA surtax in 2005; and (4) increases the deductible percentage of business meal expenses to 55 percent in 2006 (from the current level of 50 percent) and to 60 percent in 2007.

IRA Contributions. H.R. 2488 increases the adjusted gross income limitation on IRA contributions from $2,000 to $3,000 in 2001, to $4,000 in 2004, and to $5,000 in 2006 (indexed to inflation after 2008). In addition, the measure allows married couples who file joint returns and have an adjusted gross income of up to $200,000 to convert a deductible or nondeductible IRA into a Roth IRA, beginning in 2003 (the current law limit is $100,000 for both single individuals and married couples who file jointly).

Alternative Minimum Tax. The bill phases out the alternative minimum tax for individuals and reduces it for corporations.

Expiring Tax Credits. The measure extends a number of expiring tax credits, including the research & development tax credit for five years, and both the work opportunity and welfare-to-work tax credit for two-and-one-half years.

Adoption Tax Credit. H.R. 2488 expands the adoption tax credit for individuals who adopt children with special needs, providing $300 million in tax relief over 10 years. The measure increases the credit to $10,000 beginning in 2001 (under current law, the tax credit is $6,000 for special needs adoptions).

Medicare Prescription Drug Deduction. The measure allows Medicare beneficiaries to take an above-the-line deduction (*i.e.*, individuals may take the deduction whether or not they itemize) to cover the cost of prescription drug insurance coverage, contingent upon certain Medicare changes.

Oil & Gas Industries. H.R. 2488 includes several measures to provide relief to the domestic oil and gas industry. Specifically, the bill provides a special five-year "carryback" for certain eligible oil and gas operators, allowing these operators to carry back a net loss in its operations to prior years, for up to five years back, and apply it federal income taxes paid during that period. The bill also suspends (for five years) the 65 percent of taxable income limit on percentage depletion deductions.

Revenue Offsets. The measure includes a number of revenue offsets amounting to approximately $5 billion over 10 years.

Sunset Requirements. The bill sunsets all tax reductions outlined in the measure after 2009 (although certain provisions sunset after 2008).

Background:

Contract with America

As the crown jewel of the *Contract with America*, the House passed the 1995 Tax Fairness and Deficit Reduction Act (H.R. 1215; *H.Rept. 104-84*) to provide Americans with comprehensive tax relief. The bill included a $500 per-child tax credit, outlined measures to alleviate the marriage penalty, created tax-free American Dream savings accounts, repealed the 1993 tax increase on Social Security benefits, and provided a 50 percent exclusion for capital gains—indexing it to account for inflation—while eliminating the 28 percent maximum rate. The president vetoed the measure.

Later in the 104th Congress, lawmakers enacted limited tax relief (*P.L. 104-188*) targeted to small businesses and designed to mitigate the impact of a 90-cent increase in the minimum wage authorized in the legislation. Specifically, the law (1) increased expensing for small businesses; (2) modified the rules regarding Subchapter S corporations to make it easier for small businesses to expand; (3) established a new simplified pension plan for small businesses with fewer than 100 employees; (4) extended a number of expiring tax credits; and (5) established charitable risk pools to allow organizations to pool insurance costs for their members in order to reduce premium costs. Finally, the measure established a $5,000 tax credit to encourage a greater number of adoptions.

Major Tax Legislation in the 105th Congress

1997 Taxpayer Relief Act. After lengthy and tension-fraught negotiations with the White House throughout the 104th Congress, the Republican leadership and the president agreed to a comprehensive plan to balance the budget that included $275 billion in tax relief over 10 years as well as reforms to slow the growth of entitlement programs, such as Medicare and Medicaid. As part of the balanced budget agreement, Congress enacted the Taxpayer Relief Act (*P.L. 105-34*), which included many of the provisions outlined in *Contract with America*, such as providing a $500 per-child tax credit, reducing capital gains and estate taxes, expanding IRAs, creating the Roth IRA, as well as the HOPE and lifetime learning education tax credits.

Education Savings Accounts. In October 1997, the House passed legislation (H.R. 2646; *H.Rept. 105-332*) to (1) expand the acceptable use of tax-free expenditures from education savings accounts (ESAs) to include elementary and secondary school expenses, (2) increase to $2,000 annually (from the current law level of $500) the maximum amount of contributions that may be made to an ESA, and (3) include corporations as parties who may contribute to an ESA. However, the president vetoed the measure.

1998 Taxpayer Relief Act. Congress attempted to enact additional tax relief in 1998, as the House passed H.R. 4579 (*H.Rept. 105-739*), which provided $80 billion in tax relief over five years, primarily targeting toward married couples, farmers and ranchers, senior citizens, and small businesses. Specifically, the bill included measures to reduce the impact of the marriage penalty and raise the earnings limit for elderly persons who receive Social Security benefits and are between full retirement age and 70 years of age to $39,750 in 2008. It also expanded current law to allow private higher education institutions to qualify to participate in a state's prepaid tuition program. H.R. 4579 established a $1 million exemption from estate taxes for estates that are transferred to surviving relatives beginning in 1999, increased the deduction for health insurance of self-employed individuals to 100 percent beginning in 1999, and extended a number of expiring tax provisions.

The Senate failed to consider the bill before its October adjournment. Instead, Congress enacted the FY 1999 Omnibus Appropriations Act (*P.L. 105-277*), which provided limited tax relief and extended several expiring tax provisions. Specifically, the law extended the research, work opportunity, and welfare-to-work tax credits through June 1999. It also expanded taxpayers' ability to deduct health care insurance premiums if they are self-employed and increased the deduction of health insurance for self-employed individuals to 75 percent for tax years beginning in 2002 and to 100 percent for tax years beginning in 2003 and thereafter.

FY 2000 Budget Proposals

The Republican leadership identified tax relief as one of its four top priorities in the 106th Congress, along with improving education, protecting Social Security and Medicare, and bolstering the national defense. The FY 2000 budget resolution passed by Congress outlined a plan to use all of the surpluses in the Social

Security Trust Fund to save Social Security and Medicare and use the on-budget surpluses primarily for tax cuts. Specifically, the budget resolution called for (1) providing a tax cut of approximately $15 billion in FY 2000, $142 billion over five years, and $778 billion over 10 years; and (2) establishing a "lock box" to reserve all of the $1.8 trillion in cumulative Social Security surpluses over the next 10 years (as opposed to the president's plan to divert only a portion of the surpluses) to ensure it is not spent for other purposes. The House overwhelmingly passed lock box legislation (H.R. 1259) by a vote of 416-12 on May 26; however, Senate Democrats have blocked the proposal from moving forward to a full vote, despite the president expressing support for the legislation.

The president's FY 2000 budget proposal called for four targeted tax cuts to provide $36 billion in tax relief over five years. However, his budget also called for increasing taxes by a net $46 billion over the same period, including a $34 billion increase in tobacco excise taxes and extension of Superfund taxes. The president's proposal included (1) a $1,000 long-term care tax credit to help pay for formal and informal long term care services for about two million Americans; (2) a $1,000 tax credit for work-related expenses for people with disabilities, (3) tax credits to subsidize school construction; and (4) increasing eligibility for the child and dependent care tax credit. President Clinton recently indicated that he now supports $327 billion in tax relief over 10 years.

Budget Surpluses and Tax Relief

The mid-year economic and budget outlook released July 1 by the Congressional Budget Office (CBO) increased projected total budget surpluses over the 10-year projection period by $331 billion compared to the surpluses projected in April (these numbers are outlined in the chart below). The new projections show a total budget surplus in FY 1999 of $120 billion, and surpluses growing to a level of $413 billion by FY 2009. CBO projects five- and 10-year surpluses of $1.1 trillion and $2.9 trillion, respectively. The on-budget accounts (i.e., without using funds from the Social Security surpluses) are expected to reflect a surplus beginning in FY 2000 ($14 billion) that is expected to grow to $178 billion by FY 2009.

Earlier this year, when projected surpluses were somewhat smaller, President Clinton argued for using the surpluses to "save Social Security first" and opposed a large tax cut. Republican leaders, while addressing the Social Security problem through lock box legislation, also placed emphasis on providing tax relief to all Americans, contending that it is possible to provide tax relief *and* save Social Security and Medicare. However, because of the new projections—and not wanting to lose the tax issue to Republicans—President Clinton has indicated that he now supports $327 billion in tax relief over 10 years. The debate now is no longer about whether there should be tax relief, but how much and in what form.

Provisions:

— Family Tax Relief —

The bill provides $508.1 billion in family tax relief over the next 10 years. These provisions are outlined below.

Broad-Based Tax Relief

H.R. 2488 reduces all individual income tax rates by one percentage point to provide $283 billion in tax relief over 10 years. Specifically, the measure reduces (1) the 15 percent rate to 14 percent (a 6.7 percent reduction); (2) the 28 percent rate to 27 percent (a 3.6 percent reduction); (3) the 31 percent rate to 30 percent (a 3.2 percent reduction); (4) the 36 percent rate to 35 percent (a 2.8 percent reduction); and (5) the 39.6 percent rate to 38.6 percent (a 2.5 percent reduction). The bill reduces the 15 percent income tax rate to 14.5 percent in 2001 and to 14 percent in 2003. The bill reduces all other rates by one percentage point in 2005.

The measure also expands the new 14 percent tax bracket for single and head of household returns by $3,000 in 2006. Beginning in 2007, the $3,000 amount is indexed to inflation.

Beginning in 2002, the tax reductions outlined above are contingent on there being no increase in interest outlays for total U.S. federal government debt (*i.e.*, public and trust fund debt). If interest outlays increase (if total debt increases), the conference agreement delays the next phase of the tax reductions for one year.

Marriage Penalty Tax Relief

The bill contains several measures to reduce the impact of the "marriage penalty" inherent in the tax code. Under the current federal income tax system, some married couples pay more income tax than they would as two unmarried singles (a marriage tax penalty) while other married couples pay less income tax than they would as two unmarried singles (a marriage tax bonus). As a general rule, two-income married couples whose earnings are evenly split (no more than 70-30) suffer from the marriage penalty, while those couples whose income is largely attributable to one person generally receive a marriage bonus. Critics of current tax law contend that it is prejudiced against people who marry because their increased tax burden reduces family resources in times when demands on their finances increase. Approximately 21 million American couples pay higher taxes simply because they are married and their combined incomes push them into a higher tax bracket.

Married Couples. The measure provides $117 billion in marriage penalty tax relief. Specifically, the bill (1) increases the standard deduction for married couples to twice that of a single person (phased in over five years); and (2) increases the new 14 percent tax bracket to twice that of singles beginning in 2005, phased in over four years; and (3) increases by $2,000 the amount a joint-filing couple may earn before their earned income tax credit benefits begin to phase out, beginning in 2006.

Repealing the Alternative Minimum Tax (AMT)

H.R. 2488 reduces and phases in a repeal of the alternative minimum tax for individuals. The bill accomplishes this by gradually reducing AMT liability. Specifically, beginning in 2003, only 80 percent of the full AMT liability will be imposed. The bill reduces this percentage to 70 percent in 2004, 60 percent in 2005, 50 percent in 2006 and 2007, and the tax is fully repealed after 2007. The repeal of the individual AMT eliminates the present-law marriage penalty in the individual AMT. The bill also makes permanent the provision allowing non-refundable personal tax credits to be used fully without regard to the AMT.

Although the AMT was originally designed to ensure that high-income taxpayers pay some minimum tax and not escape their "fair" share of the income tax burden, there will be a significant increase in the number of middle-income taxpayers subjected to the AMT. Currently, about 600,000 taxpayers are subject to the AMT, but estimates indicate that more than 20 million taxpayers may be subject to the tax by 2007.

Adoption Tax Credit

The measure expands the adoption tax credit for individuals who adopt children with special needs. The bill increases the credit to $10,000 beginning in 2001 (under current law, the tax credit is $6,000 for special needs adoptions). In addition, taxpayers adopting a special needs child are deemed to have paid or incurred $10,000 of qualified expenses in all cases.

Foster Care Payments

The bill expands the list of persons eligible to make qualified foster care payments to include a state, a political subdivision of a state, or a qualified foster care placement agency (whether it is tax-exempt or not). The measure also allows the three entities outlined above to place foster care individuals in qualified homes.

Dependent Care Credit

H.R. 2488 expands the dependent care credit by increasing the limits for eligible qualified expenses from 30 percent to 35 percent beginning in 2001 and to 40 percent beginning in 2006 for taxpayers with adjusted gross income of $30,000 or less. The credit is lower for taxpayers in higher incomes. Beginning in 2001, the maximum amount of eligible employment-related expenses ($2,400/$4,800) is indexed to inflation. Finally, the bill extends up to $960 of additional credit ($1,920 for two or more dependents) to taxpayers with qualifying dependents under the age of one.

— Savings and Investment Tax Relief Provisions —

H.R. 2488 provides $67.3 billion in tax relief to encourage saving and investment over the next 10 years. These changes are detailed below.

Capital Gains Taxes. H.R. 2488 reduces the individual capital gains tax rates from 20 percent to 18 percent and from 10 percent to eight percent (for taxpayers in the 15 percent individual income tax bracket). The rate reduction is effective retroactively to January 1, 1999. Beginning in 2000, capital gains are indexed to inflation. In addition, the measure reduces the 25 percent capital gains rate for depreciable real estate held for more than one year to 23 percent effective retroactively to January 1, 1999. Finally, the bill extends current capital gains rates to capital gains of designated settlement funds (which are now taxed at the highest individual income tax rate, 39.6 percent).

IRA Contributions. The bill increases the adjusted gross income limitation on IRA contributions from $2,000 to $3,000 in 2001, to $4,000 in 2004, and to $5,000 in 2006 (indexed to inflation after 2008). In addition, the measure allows married couples who file joint returns and have an adjusted gross income of up to $200,000 to convert a deductible or nondeductible IRA into a Roth IRA, beginning in 2003 (the current law limit is $100,000 for both single individuals and married couples who file jointly).

The measure increases adjusted gross income limits for Roth IRA contributions to $200,000 for individuals and $210,000 for joint filers beginning in 2003 (current law limits contributions to $100,000/$110,000). Finally, the bill allows individuals over age 50 to make additional contributions to an IRA.

Excluding Certain Earnings by Members of Uniformed or Foreign Services. Under current law, an individual taxpayer may exclude up to $250,000 ($500,000 for married couples filing joint tax returns) of gain realized when they sell their principal residence. In order to be eligible, a taxpayer must have owned or used the residence for at least two of the five years before its sale or exchange.

The measure suspends this five-year test for ownership and use for individuals during certain absences due to service in the uniformed services (*i.e.*, the Army, Navy, Air Force, Marine Corps, and Coast Guard), the Foreign Service, or commissioned corps of the Public Health Service or National Oceanic and Atmospheric Administration (NOAA). Specifically, the bill suspends this provision any time during which the owner was assigned on official extended duty for at least 90 days, or for an indefinite period, at a place at least 50 miles from the residence or if the owners were required to live away from the residence or under orders compelling residence in government furnished housing. In addition, the measure suspends the five-year test for ownership and use (for up to five years) for taxpayers who are relocated overseas by their employer.

Other Provisions. The bill also (1) modifies the treatment of worthless securities (*i.e.*, securities with no value) of certain financial institutions; and (2) clarifies the tax treatment of income and losses from derivatives.

— Business Investment and Job Creation —

H.R. 2488 provides $7.9 billion in tax relief to spur business investment and job creation over the next 10 years. These changes are outlined below.

Corporate Alternative Minimum Tax. The measure allows a corporation to use minimum tax credits to offset 50 percent of their tentative minimum tax, but not below their regular tax liability for taxable years beginning in 2005. Current law imposes a minimum tax on a corporation to the extent that its minimum tax liability exceeds its regular tax liability (*i.e.*, the corporation must calculate two separate tax liabilities and then pay the larger of the two amounts). The bill also allows corporations to use AMT net operating loss deductions to offset 100 percent (rather than 90 percent under current law) of their alternative minimum taxable income.

AMT Limit on Foreign Tax Credits. The bill repeals the 90-percent limitation on utilizing the AMT foreign tax credit. Taxpayers may reduce their AMT liability by using an AMT foreign tax credit. Under current law, this tax credit generally may not offset a taxpayer's entire pre-credit AMT. Rather, it is limited to 90 percent of the AMT without certain deductions.

— Education Tax Relief —

The bill provides $11.3 billion in education tax relief over the next 10 years. These changes are detailed below.

Education Savings Accounts. H.R. 2488 amends the tax code to (1) expand the acceptable use of tax-free expenditures from education IRAs—commonly referred to as education savings accounts (ESAs)—to include elementary and secondary school expenses; (2) increase to $2,000 annually the maximum amount of contributions to ESAs; and (3) include corporations as parties who may contribute to an ESA.

Current law allows annual ESA deposits of up to $500 from parents or other family members, and restricts the use of funds only for post-secondary education expenses. In addition, the bill allows contributions to an ESA for a special needs beneficiary older than age 17 (current law generally restricts contributions to designated beneficiaries age 17 or younger). Finally, the bill makes a number of other miscellaneous changes to education IRAs. The House passed similar provisions in the 105th Congress (H.R. 2646; *H.Rept. 105-332*), but the president vetoed the measure.

Prepaid Tuition Programs. The bill authorizes private higher education institutions to offer tax-deferred, pre-paid tuition plans and exempt the earnings of all such plans from taxation. Current law, as established by the 1996 Small Business Job Protection Act (*P.L. 104-188*), limits qualified prepaid tuition programs to those offered by state-run colleges, universities, and vocational schools, allowing certain relatives such as parents and grandparents to contribute money to special accounts to pre-fund education expenses for their children. Generally, the accounts, their contributions, and any interest earned are tax-free until benefits received by the beneficiary exceed the costs of their education expenses or contributors receive a refund of their deposits that exceeds the amount of their contributions. Finally, the bill (1) allows tax-free distributions from qualified state tuition programs to pay for qualified higher education expenses beginning in 2000; and (2) allows tax-free distributions from tuition programs established and maintained by private institutions beginning in 2004.

School Construction. H.R. 2488 increases from two to four years the period during which a state or local government may avoid paying "arbitrage rebates" to the federal government on public school construction bonds. Under current law, state and local governments may issue tax-exempt bonds to finance school construction activities, as well as a variety of other public facilities and services. Proceeds from the bonds may be invested, but state and municipal governments must pay profits to the federal government. This revenue must be repaid to the federal government in five-year intervals. However, certain bonds qualify for exemption from repayment terms.

In the case of school construction bonds, current law requires that money from the sale of the bonds must be spent within 24 months of their sale in the following increments: 10 percent of the bond revenue must be spent within the first six months of being issued; 45 percent within the first 12 months; 75 percent within the first 18 months; and 100 percent within two years. H.R. 2488 expands this interval period to a total of four years: 10 percent or more of the construction bond proceeds must be spent within one year of issue; 30 percent or more within two years; 60 percent or more within three years; and all funds must be spent within four years.

Finally, the bill increases the amount of government bonds for public schools that localities may issue without being subject to the arbitrage rebate requirement from $5 million to $10 million. These measures are designed to give school districts greater flexibility when issuing bonds and building public schools.

Medical Scholarships. H.R. 2488 provides tax exemptions for certain federal medical scholarships and comparable state-sponsored programs approved by the Treasury Secretary. Current law provides tax exemptions for scholarships under certain conditions. However, students do not qualify for these exemptions if their scholarship constitutes payment for certain activities, such as teaching, research, or other services. The National Health Service Corps Scholarship Program, the Armed Forces Scholarship Program, and the NIH Undergraduate Scholarship Program provide education awards to participants on the condition that participants provide such services, including work in underserved areas for a designated period after graduation. Because scholarship recipients in these programs must perform services in exchange for their education awards, the awards used to pay higher education expenses are thus considered taxable income.

Employer-Provided Educational Assistance. The bill extends the tax exclusion for employer-provided educational assistance for undergraduate-level courses through December 31, 2003. This credit, which does not currently apply to graduate courses, currently expires on June 1, 2000. Thus, the bill extends the exclusion to graduate education beginning in 2000 and effective through 2003. This provision provides approximately $1.4 billion in tax relief over five years.

Student Loan Interest Deduction. The measure eliminates the 60-month limitation on student loan interest deductions. The 1997 Taxpayer Relief Act allows taxpayers to deduct student loan interest from their gross income, subject to a maximum annual deduction limit. However, the deduction is allowed only on interest paid on a loan during the first 60 months in which interest payments are required. In addition, the bill increases the student loan interest deduction income limit for individual taxpayers from $40,000 to $45,000 and to twice that of a single taxpayer for married couples who file joint returns

Professional Development Expenses. Under current law, employees may deduct work-related education and other business expenses if they exceed two percent of the taxpayer's adjusted gross income. The bill provides an exception to the two-percent deduction rule (which may not exceed $1,000) for elementary and secondary schoolteacher professional development expenses. Qualified expenses include tuition, fees, books, supplies, equipment, and transportation required for enrollment in courses or professional conferences that are certified by the appropriate local educational agency. The provision is effective beginning in 2001 and terminates in 2005.

— Health Care Tax Provisions —

H.R. 2488 provides $43.9 billion in tax relief over the next 10 years to make health care and long term care more affordable. These changes are detailed below.

Health Insurance Deduction and Long-Term Care Provisions. The measure phases in a 100 percent above-the-line deduction (*i.e.*, an individual may take the deduction whether or not he itemizes) for health insurance medical care expenses (as well as expenses for qualified long-term care insurance that constitutes medical care) where the taxpayer pays more than 50 percent of the premiums. The bill applies the 50 percent rule separately to health insurance and qualified long-term care insurance. The bill phases in the deduction at 25 percent in 2001-2004; 35 percent in 2005; 65 percent in 2006; and 100 percent in 2007 and thereafter. The bill also allows employers to offer qualified long-term care insurance through cafeteria plans (*i.e.*, a written benefit plan under which employees may choose between receiving cash and certain nontaxable benefits such as health coverage or dependent care) and allows qualified long-term care services to be provided under flexible spending arrangements.

Medicare Prescription Drugs. The bill provides an above-the-line deduction for prescription drug insurance coverage of Medicare beneficiaries, contingent upon certain Medicare changes. Specifically, the deduction will not take effect unless (1) the federal government authorizes assistance for prescription drug insurance for low-income Medicare beneficiaries; (2) all Medicare insurance supplemental policies provide coverage for prescription drug costs; and (3) Congress enacts certain other structural Medicare reforms relating to prescription drug coverage. In addition, the bill stipulates that "medical expenses" include formerly prescription drugs (*i.e.* drugs that used to be available through prescription only) for Medicare enrollees who itemize their medical expenses, beginning in 2003.

Other Provisions. H.R. 2488 also (1) provides an additional dependency deduction (currently $2,750) for individuals who care for elderly parents or grandparents in their home; (2) increases the time period for measuring eligible expenses qualifying for the orphan drug tax credit; (3) includes a vaccine against streptococcus pneumonia to the list of taxable vaccines; and (4) reduces the tax applied to all taxable vaccines from 75 cents per dose to 50 cents per dose for vaccine sales beginning in 2005.

— Estate and Gift Tax Relief —

H.R. 2488 provides $65.6 billion in estate and gift tax relief over the next 10 years. These changes are outlined below.

Estate, Gift, and GST Taxes. The measure repeals the estate, gift, and generation-skipping transfer (GST) taxes over 10 years. Beginning in 2001, the bill replaces the unified credit with a unified exemption, repeals the five percent surtax and rates in excess of 50 percent, and reduces the estate, gift, and GST tax rates annually until they are repealed in 2009 (coordinating these tax rates with individual income tax rates). Finally, the bill makes a number of modifications to the GST tax prior to its repeal.

The federal estate and gift taxes are a unified tax system: a transfer of wealth, whether made during the life of the donor or at death, is taxed under the same general structure. The unified estate and gift tax rates begin at 18 percent on the first $10,000 in cumulative taxable transfers and reach 55 percent on such transfers over $3 million. The government imposes a five percent surtax on cumulative taxable transfers between $10 million and the amount necessary to phase out the benefits of the graduated rates. Under the 1997 Taxpayer Relief Act (*P.L. 105-34*), the unified credit exempts $650,000 in 1999, which increases to $675,000 in 2000 and 2001, $700,000 in 2002 and 2003, $850,000 in 2004, $950,000 in 2005, and $1 million in 2006 and thereafter.

The GST tax is designed to prevent an individual from transferring property to successive generations without being subject to the estate and gift tax for each generation. A $1 million exemption (indexed to inflation beginning in 1999) is provided for each individual making generation-skipping transfers.

Conservation Easements. H.R. 2488 expands the availability of qualified conservation easements by modifying certain distance requirements. Specifically, the bill increases the distance from which the land must be situated from a metropolitan area, national park, or wilderness area from 25 to 50 miles, and from an Urban National Forest from 20 to 25 miles. It also clarifies that the date for determining easement compliance is the date on which the donation is made. Under current law, an executor may exclude from the taxable estate 40 percent of the value of any land subject to a qualified conservation easement, up to a maximum exclusion of $100,000 in 1998, $200,000 in 1999, $300,000 in 2000, $400,000 in 2001, and $500,000 in 2002 and thereafter.

— Pension Reforms —

H.R. 2488 outlines $14.9 billion in pension tax relief and measures designed to reform pension systems and enhance retirement security. These include the following:

Expanding Coverage. The measure increases contribution and benefit limits in tax-favored retirement plans. Specifically, the bill (1) increases the $30,000 annual contribution limit for defined contribution plans to $40,000; (2) increases the $130,000 annual benefit limit under a defined benefit plan to $160,000; and (3) increases the $160,000 compensation limit to $200,000. The bill also extends the "Roth IRA" concept (*i.e.*, depositing after-tax contributions to receive tax-free distributions) to 401(k) and 403(b) plans (otherwise known as "tax-deferred annuities") whereby participants may elect to have salary deferrals treated as after-tax contributions.

Beginning in 2001, the bill increases the dollar limit on annual elective deferrals under section 401(k) plans, tax-deferred annuities, and salary reduction simplified employee pension plans (SEPs) in $1,000 annual increments until the limits reach $15,000 in 2005. Beginning in 2001, the proposal increases the maximum annual elective deferrals that may be made to a SIMPLE retirement account in $1,000 annual increments until the limit reaches $10,000 in 2004. The measure increases the dollar limit on deferrals under a section 457 plan (*i.e.*, an eligible deferred compensation plan of a state or local government or tax-exempt employer) to conform to the elective deferral limitation. Thus, the limit will be $11,000 in 2001 and continue to increase in $1,000 annual increments until it reaches $15,000 in 2005. The above limits will be indexed annually thereafter in $500 increments.

In addition, the bill (1) modifies and simplifies "top-heavy rules"; (2) stipulates that elective deferral contributions will not be considered when calculating deduction limits; (3) repeals coordination requirements for section 457 plans of state and local governments and tax-exempt organizations; (4) eliminates IRS user fees for determination letter requests by small employers; (5) increases the minimum benefit safe harbor under defined benefit plans; (6) eliminates present-law rules relating to plan loans to an owner-employee; and (6) reduces PBGC premiums for small and new plans. The bill makes a number of other minor changes.

Enhancing Fairness for Women. H.R. 2488 also (1) allows additional salary reduction "catch-up" contributions for workers over age 50 (*i.e.*, individuals may deposit additional amounts into certain retirement accounts); (2) accelerates vesting requirements for employer matching contributions; (3) provides equitable treatment for contributions to defined contribution plans by eliminating "percentage of compensation" limits; (4) simplifies and updates minimum distribution rules that apply to tax-favored plans; (5) clarifies the tax treatment on the division of section 457 plans upon divorce; and (6) modifies safe harbor relief provisions for hardship withdrawals from 401(k) plans.

Portability. The measure increases portability of retirement assets so employees may roll over such assets from one job to the next. Specifically, the bill allows individuals to roll over eligible distributions from qualified retirement plans, tax-deferred annuities, and section 457 state and local governments plans. In addition, the bill allows employees to roll over after-tax contributions into another qualified plan in a direct rollover, or to an IRA. Finally, the bill (1) expands spousal rollovers; (2) allows pension plans to eliminate unnecessary distribution options; (3) allows employers to disregard rollovers for purposes of cash-out rules; (4) allows employees to access benefits from 401(k) plans, tax-deferred annuities, and section 457 plans after "severing employment" rather than "separating from service" (*i.e.*, allows distributions when an employee continues in the same job after a merger); (5) allows a hardship exception to the 60-day rollover rule; and (6) allows the use of tax-deferred annuity and section 457 plan assets to purchase service credit in government-defined benefit plans.

Pension Security. H.R. 2488 phases in the repeal of the current 150 percent contribution limit to defined benefit plans by 2004. Present law contributions to plans that exceed 150 percent of current liability are not tax-deductible (this limit will phase up to 170 percent by 2003). In addition, the bill expands the missing participant program to include defined contribution plans to allow individuals to locate 401(k) money they may have left with a previous employer. The bill also provides excise tax relief for sound pension funds and requires plan administrators to notify recipients of significant reductions in future benefits. The measure includes a number of other provisions designed to allow companies to better fund their plans and strengthen disclosure requirements.

Regulatory Burdens. H.R. 3081 includes a number of provisions designed to simplify the pension system to help small businesses offer, and large employers improve, their pension plans. Specifically, the bill (1) allows employers to reinvest employee stock ownership plan dividends without losing the dividend deduction; (2) repeals transition rules relating to certain highly compensated employees; (3) simplifies annual filing requirements for pension plans with fewer than 25 employees; (4) repeals several complex regulatory tests required of employers; (5) directs the Treasury Secretary to modify mechanical nondiscrimination requirements to provide additional flexibility; (6) clarifies the tax treatment of employer-provided retirement planning services; (7) modifies the timing of plan valuations; and (8) clarifies the status of church welfare plans under state insurance laws. Finally, the bill makes several other miscellaneous changes.

— *Community Renewal* —

H.R. 2488 provides $3.1 billion in tax relief over the next 10 years to distressed communities and industries. These provisions are detailed below.

Community Renewal. The measure authorizes the HUD Secretary to designate 20 "renewal communities" in both urban and rural areas, allowing them to qualify for special tax incentives (at least three must be in rural areas). The bill requires the secretary to adhere to certain eligibility criteria and procedures when designating these communities. These provisions are designed to create jobs, stimulate investment, and assist families in impoverished neighborhoods. In addition to their special designation, renewal communities will receive additional tax incentives over a seven-year period from 2001 through 2007. They include:

* **100-percent Capital Gain Exclusion**. H.R. 2488 eliminates capital gains taxes on the sale of any qualified stock, business property, or partnership interest located within renewal communities that have been held for at least five years and that are acquired between 2001-2007.

* **Family Development Accounts**. The bill establishes family development accounts (FDAs), tax-exempt accounts that allow taxpayers to deduct up to $2,000 for amounts paid in cash to FDAs to benefit "qualified persons"—a person who both lives in the renewal community during the tax year and claims the earned income tax credit in the preceding tax year. In addition, other individuals may deduct up to $1,000 annually to benefit a qualified person. FDAs are designed to encourage low-income families to save a portion of their income or their earned income tax credit refund.

  Cash donations are deductible, even if the individual does not itemize, while withdrawals are tax-free if used for a qualified purpose (*i.e.*, post-secondary educational expenses, certain first-home purchases, certain business capitalization costs approved by a financial institution or by a nonprofit loan fund, or medical expenses). The measure allows certain qualifying tax-free rollovers of FDA amounts into other accounts to benefit an individual (or a spouse or dependent).

* **Commercial Revitalization Deduction**. H.R. 2488 allows taxpayers to claim a "commercial revitalization deduction" (*i.e.*, an up-front deduction of 50 percent of the cost of renovation or a 100 percent deduction for such costs spread over 10 years) for efforts to build or refurbish commercial-use buildings in renewal communities during a seven-year period between 2001 and 2007. Deductions may equal up to $10 million per location. In addition, states may allocate up to $6 million in deductions to each renewal community in the state annually during the seven-year period.

* **Additional Section 179 Expensing**. The measure raises the maximum allowable expense deduction for purchases of plant and equipment in renewal communities from $25,000 to $35,000. Businesses in areas with dual-designations may deduct up to $55,000 ($20,000 of additional expenses under current law empowerment zone provisions, and $35,000 in expenses under renewal community provisions). Deductions may be applied to property valued at up to $200,000 and will be phased out proportionately as the property's value exceeds that amount.

* **Expensing Environmental Remediation Costs ("Brownfields")**. H.R. 2488 permits taxpayers to expense costs incurred in mitigating the impact of environmental contaminants within a designated renewal community. This provision applies to expenditures incurred between 2001 and 2007.

* **Work Opportunity Tax Credit (WOTC)**. The bill provides the WOTC to employers who hire individuals who live and perform most of their work in a renewal community. In addition, should the WOTC expire, businesses located in renewal communities may qualify for a 15-percent tax credit on first year wages (up to $10,000) paid to low-income workers. The credit increases to 30 percent on second-year wages.

Tax Relief for Farmers. The bill stipulates that federal farm production payments are taxable in the year received. Under current law, annual production flexibility contract payments are made twice a year, in December or January and again in September. The 1998 Omnibus Appropriations Act (*P.L. 105-277*) allowed recipients to specify when they wished to receive their FY 1999 payments. Thus, the September payments may be specified for payment in calendar year 1998. This option potentially may have resulted in payments being included in a farmer's taxable income, whether or not they were in fact received in that tax year.

Oil & Gas Industries. The bill includes several measures to provide relief to the domestic oil and gas industry. Specifically, the bill provides a special five-year "carryback" for certain eligible oil and gas operators, allowing these operators to carry back a net loss in its operations to prior years, for up to five years back, when the operation paid federal income taxes. The bill also suspends (for five years) the 65 percent of taxable income limit on percentage depletion deductions. In addition, the bill allows the industry to deduct geological and geophysical expenditures and delay rental payments. Finally, the bill modifies the definition of a "small refiner" which is eligible for percentage depletion deductions.

Other Provisions. The bill also (1) increases the cap on expenditures eligible for the reforestation credit from $10,000 to $25,000 per taxable year (from $5,000 to $12,500 for a separate return by a married individual) and eliminates the cap on expenditures eligible for seven-year amortization during 2001-2003; and (2) clarifies and simplifies the capital gains law regarding sales for timber by a land owner.

— *Small Business Tax Relief* —

H.R. 2488 provides $10.4 billion in small business tax relief over the next 10 years. These changes are outlined below.

Self-Employed Health Insurance Deduction. H.R. 3081 increases the deduction for health insurance (as well as qualified long-term expenses) of self-employed individuals to 100 percent beginning in 2001. This provision modifies current law, which does not phase in full deductibility of health insurance expenses for self-employed individuals until 2003. Under current law, individuals may deduct 60 percent of their health insurance expenses in 1999 through 2001, 70 percent in 2002, and 100 percent in 2003. However, the deduction is not available in any month that the taxpayer participates in a subsidized health plan maintained by the taxpayer's employer or his/her spouse.

Increase in Expensing for Small Businesses. The bill increases the small business equipment expense deduction to $30,000 annually beginning in 2000. Current law phases in a $25,000 deduction limit over five years, reaching this level in 2003; small business taxpayers may currently deduct $19,000.

Federal Unemployment Tax Act (FUTA). The measure repeals the 0.2 temporary percent FUTA surtax after December 31, 2004. The surtax finances administration of the unemployment system. In 1976, Congress passed a temporary surtax of 0.2 percent of taxable wages as an add-on to the permanent FUTA tax rate of 0.6 percent. The temporary surtax has been subsequently extended through 2007.

Farm, Fish, and Ranch Risk Management (FFARRM) Accounts. The bill allows taxpayers engaged in eligible farming, fisher, and ranch businesses to establish FFARRM accounts beginning in 2001 and allows them to contribute up to 20 percent of their industry-specific income to these accounts. The contributions will reduce the taxable income by these businesses, but will be taxed upon distribution.

Other Provisions. H.R. 2488 also (1) extends farmer income averaging to commercial fishermen and coordinates the averaging rules with the alternative minimum tax, effective in 2001; and (2) stipulates that interest and certain dividend income of S corporation banks is not treated as passive income and allows S corporation banks to have director shares of stock.

— *International Tax Relief* —

H.R. 2488 provides $31.2 billion in tax relief over 10 years designed to maintain U.S. corporate global competitiveness and increase the competitiveness of U.S. workers and companies. Specifically, the bill (1) modifies interest expense allocation rules; (2) increases the exclusion for foreign-earned income; (3) clarifies the treatment of pipeline transportation income as well as income from the transmission of high voltage electricity; (4) modifies current law on recharacterized overall domestic losses; (5) repeals the special foreign sales corporation limitation on the export of military property; (6) stipulates that a regulated investment company will not be subject to U.S. tax under certain conditions; (7) repeals certain rules for applying the foreign tax credit in the case of foreign oil and gas income; (8) provides a waiver when foreign tax credits are denied under certain circumstances; and (9) prohibits the disclosure of advance pricing agreements (APAs) and APA background files. The bill includes several other miscellaneous international tax relief provisions.

— *Tax-Exempt Organizations* —

The measure outlines $1.8 billion in tax relief over 10 years for tax-exempt organizations. Specifically, the bill provides tax-exempt status for any association created before January 1, 1999, by state law and organized and operated exclusively to provide property and casualty insurance coverage to underserved markets based on certain conditions. In addition, the bill (1) conforms provisions relating to arbitrage treatment to reflect proposed state constitutional amendments; (2) simplifies lobbying expenditure limitations; (3) requires the Treasury Secretary to establish an exemption for excise taxes on self-dealing (*e.g.*, selling or leasing property or providing other services to tax-exempt private foundations) if certain conditions are met; (4) extends declaratory judgment procedures for determining an organization's tax-exempt status—currently available only to charities—to other organizations (*e.g.*, trade associations, labor and agricultural organizations, and other fraternal groups); (5) modifies how unrelated business income is determined for certain entities controlled by tax-exempt organizations; (6) establishes an exclusion from gross income for mileage reimbursements by charitable organizations; (7) allows individuals to claim a deduction for expenses from carrying out sanctioned whaling activities; and (8) excludes from gross income distributions from an IRA to charitable organizations. The bill makes several other minor changes to current law.

— *Real Estate Tax Provisions* —

H.R. 2488 provides $7.3 billion in real estate tax relief over the next 10 years. These provisions are detailed below.

Real Estate Investment Trusts (REITs). The bill makes several modifications to the rules governing REITs. Specifically, the measure (1) prohibits a REIT from owning more than 10 percent of the total value of securities of a single issuer; (2) establishes rules for operating hotels and health care facilities; (3) modifies REIT distribution requirements to conform to regulated investment companies (RICs); and (4) establishes new procedures for determining whether certain rents from personal property exceed a 15 percent limit.

REITs are companies dedicated to owning and, in most cases, operating income-producing real estate, such as apartments, shopping centers, office complexes, and warehouses. Some REITs also are engaged in financing real estate. A REIT is legally required to pay virtually all of its taxable income (95 percent) to its shareholders on an annual basis. A REIT may deduct the dividends paid to the shareholders from its corporate tax bill if the company's assets are primarily comprised of real estate held for the long term, the company's income is mainly derived from real estate, and the company pays out at least 95 percent of its taxable income to shareholders. Because REITs may deduct the dividends they pay to their shareholders, they are, in substance, treated as pass-through entities under present law.

Low-Income Housing Tax Credit. The bill phases-in an increase in the $1.25 per capita cap for the low-income housing credit to $1.75 and indexes it to inflation beginning in 2004. The credit may be claimed over a 10-year period for the cost of rental housing occupied by tenants that have incomes below certain levels and is available for newly constructed or substantially rehabilitated housing.

Private Activity Tax-Exempt Bonds. H.R. 2488 accelerates the scheduled increase in the limits on tax-exempt private activity bonds to $75 per resident or $225 million if greater (the current limits through 2002 are $50 per resident or $150 million if greater) beginning in 2004 (under current law, the increase will not be effective until 2007). Interest earned on state- and municipally-issued bonds may be excluded from general income if the bond proceeds fund activities conducted and paid for by localities. Interest on such bonds used to finance activities carried out and paid for by private persons (*i.e.*, "private activity bonds") is taxable unless specifically exempted by the tax code. However, private activity bonds on which interest may be tax-exempt include bonds for (1) privately operated transportation facilities (airports, mass transit, and high speed rail systems); (2) privately owned and/or provided municipal services (water, sewer, solid waste disposal, and electric and heating systems); (3) economic development in depressed areas; and (4) certain social programs (low-income rental housing, student loan bonds).

Other Provisions. The measure also (1) modifies the at-risk rules for publicly traded securities; (2) establishes a safe harbor (*i.e.*, an exclusion from gross income) for certain inducements received by retailers in exchange for the retailer's agreement to operate a qualified retail business at a particular location for at least 15 years; (3) allows taxpayers to claim a 50 percent deduction of qualified expenditures (up to $50,000) for rehabilitating an historic home if the owner occupies the residence for five years.

— Miscellaneous Tax Provisions —

H.R. 2488 provides $3.8 billion in miscellaneous tax relief over the next 10 years. These changes are outlined below.

Business Meal Deduction. The measure increases the business meal expense deduction to 55 percent in 2006 (from the current level of 50 percent) and to 60 percent in 2007. The bill also accelerates the phase-in for this deduction for individuals subject to Transportation Department hours-of-service limitations. Under current law, the deduction is scheduled to increase from 55 percent in 1999 to 80 percent in 2008. The bill increases the deduction to 80 percent beginning in 2006.

Holocaust Victims. H.R. 2488 excludes from gross income any amount received by an individual or any heir (1) from the Swiss Humanitarian Fund established by the government of Switzerland or from any similar fund established in any foreign country; (2) as a result of the settlement of the ongoing litigation or any similar action; and (3) from the value of land recovered from a government of a foreign country as a result of a settlement of a claim arising out of the confiscation of such land in connection with the Holocaust.

Superfund. The bill consolidates the Superfund and the Leaking Underground Storage Tank (LUST) trust funds into a single Environmental Remediation Trust Fund. Amounts in the consolidated trust fund (*i.e.*, all amounts in both of the present-law trust funds) will be available for expenditure, as outlined in appropriations laws, for the combined purposes of the two trust funds. However, the conference agreement requires that the two trust funds be separated upon enactment of Superfund reform legislation and requires that LUST be reimbursed for any Superfund use of its monies.

Under current law, the two separate trust funds finance similar ground and water cleanup programs related to hazardous substances. Superfund is the principal federal program for cleaning up hazardous waste sites to protect public health and the environment from releases of hazardous substances. The LUST trust fund provides money under cooperative agreements between the Environmental Protection Agency (EPA) and states to pay cleanup and related costs involving leaking petroleum tanks. The proposal is expected to provide Superfund, whose tax authorization expired December 31, 1995, with a new source of revenue (its trust fund is estimated to have sufficient funds only FY 2000).

Medical Innovation. H.R. 2488 creates a new 40-percent credit for qualified medical research expenditures incurred at certain academic institutions with respect to human clinical testing of any drug, biologic, or medical device. The credit applies to research expenditures in excess of a base period amount and is effective retroactive to January 1, 1999.

Other Provisions. In addition, the bill (1) allows survivors of public safety officers killed in the line of duty to exclude from gross income their survivor benefits; (2) repeals the 4.3-cents-per-gallon tax on railroad and inland waterway fuels; (3) repeals the 10 percent excise tax on fishing tackle boxes and modifies the arrow excise tax; (4) repeals the 0.1-center-per-gallon LUST tax on diesel fuel used in trains; (5) equalizes the tax treatment of "clean fuel" vehicles and oversized electric vehicles; (6) increases the Joint Committee on Taxation tax refund review threshold to $2 million; (7) modifies nuclear decommissioning costs; (8) facilitates the distribution of funds from Alaska Native Corporations to Alaska Native Settlement Trusts; (9) treats the income from publicly traded partnerships as qualifying income for regulated investment companies; (10) includes several Tax Court changes; (11) expands employer reporting on annual W-2 Form tax statements; (12) expands the definition of rural airport eligible for reduced Aviation Trust Fund excise tax rates to include certain small airports that are not connected by paved road to larger airports, but are too close to those airports to qualify for reduced tax rates; (13) modifies the definition of a lending or finance company by repealing the business expense requirement and limitation on maturity of loans; (14) expands the District of Columbia homebuyer tax credit; (15) repeals the five-year limitation on life insurance companies filing a consolidated tax return with an affiliated group of non-life insurance companies; and (16) includes a number of provisions to encourage investment in specialized Small Business Investment Companies.

— *Extension of Expiring Provisions* —

H.R. 2488 provides $20.9 billion in tax relief over the next 10 years by extending a number of expiring tax credits. These provisions are detailed below.

Research & Development Tax Credit. The bill extends the R&D tax credit for five years through June 30, 2004; the credit expired on June 30, 1999. The bill also increases the applicable percentages in the alternative incremental credit by one percentage point. Research tax credits are available for qualified research expenditures that include (1) "in-house" expenses of the taxpayer for wages and supplies attributable to qualified research; (2) certain time-sharing costs for computer use in qualified research; and (3) 65 percent of amounts paid by the taxpayer for qualified research conducted on the taxpayer's behalf, or under contract with a third party. The credit is also available to corporations that pay universities and other nonprofit scientific research organizations to conduct research on behalf of the corporation.

Welfare-to-Work Tax Credit. H.R. 2488 extends the welfare-to-work tax credit for 30 months through December 31, 2001, providing approximately $272 million in tax relief. The provision provides employers with a credit on the first $20,000 of eligible wages paid to long-term welfare recipients during their first two years of employment. The credit equals 35 percent of the first $10,000 of eligible wages paid in the first year, and 50 percent of the first $10,000 in wages paid during the second year. The maximum employer benefit allowed is $8,500 per employee. A qualified long-term employee includes family members who (1) have received assistance for at least 18 consecutive months ending on the hiring date; (2) have received assistance for a total of 18 months or more after August 5, 1997 (whether consecutively or not) if they are hired within two years after the date that the 18th month of assistance is reached; and (3) are no longer eligible for assistance because of either federal or state time limits.

Work Opportunity Tax Credit (WOTC). The measure extends the WOTC for 30 months through December 31, 2001, providing approximately $1.1 billion in tax relief. This credit generally equals 40 percent (25 percent for employment of fewer than 400 hours) of qualified wages, which includes compensation earned during the first year of employment. Generally, the credit allows a maximum of $6,000 of wages per person during the first year of employment. Target groups for employers to hire from include (1) individuals eligible to receive welfare benefits; (2) certain ex-felons who are hired within one year of their release from prison or conviction date; (3) high-risk youth; (4) individuals between 18 and 25 years of age whose families have received food stamp assistance for at least six months at the time they are hired; (5) vocational rehabilitation referrals; (6) qualified summer youth employees; (7) certain veterans who receive food stamps; and (8) recipients of certain SSI benefits.

Exceptions under Subpart F for Certain Active Financing Income. The bill extends for five years (through December 31, 2004) the present-law temporary exceptions from subpart F foreign personal holding company income, foreign base company services income, and insurance income for certain income that is derived from a banking, financing, or similar business, or in the conduct of an insurance business. Under current subpart F rules, 10-percent U.S. shareholders of a controlled foreign corporation (CFC) are subject to U.S. tax currently on certain income earned by the CFC, whether or not such income is distributed to the shareholders.

Oil and Gas Wells. The bill extends for five years (through December 31, 2004) the present-law rule suspending the 100-percent-of-net-income limitation on oil and gas production from marginal wells. The tax code permits taxpayers to recover their investments in oil and gas wells through depletion deductions. In the case of certain properties, the deductions may be determined using the percentage depletion method. Among the limitations that apply in calculating percentage depletion deductions is a restriction that, for oil and gas properties, the amount deducted may not exceed 100 percent of the net income from that property in any year.

Brownfields Environmental Remediation. H.R. 2488 extends the benefits of expensing of environmental remediation expenses to all sites containing (or potentially containing) a hazardous substance other than those sites already identified as national Superfund sites expenses incurred after December 31, 1999.

Wind and Biomass Facilities. The measure extends through June 30, 2003, the tax credit for electricity produced by wind and closed-loop biomass facilities

— Revenue Offsets —

H.R. 2488 includes a number of revenue provisions amounting to approximately $5.5 billion over 10 years. Specifically, the bill (1) extends information reporting on cancellation of indebtedness to non-bank financial institutions; (2) extends Internal Revenue Service user fees through September 30, 2009; (3) imposes limitations on pre-funding certain employee benefit; (4) increases from 10 percent to 15 percent the optional withholding rate for non periodic payments from certain deferred compensation plans and IRAs; (5) modifies the treatment of closely-held real estate investment trusts (REITs) with an incubator REIT exception (*i.e.*, a modified REIT that must meet certain structural requirements); (6) limits the conversion of ordinary income or short-term capital gains into income eligible for long-term capital gain rates (*i.e.*, the difference between a 39.6 percent and a 20 percent rate); (7) extends through September 30, 2009, and slightly modifies the current-law provision that permits employers to transfer excess defined benefit plan assets to a special account for retiree health benefits.

In addition, the measure:

* prohibits the use of the installment method of accounting for dispositions of property that otherwise must be reported for federal income tax purposes using an accrual method of accounting;

* clarifies the treatment of capital gains from constructive ownership transactions;

* prohibits charitable contribution deductions for transfers associated with split-dollar insurance arrangements;

* limits the use of the non-accrual experience method of accounting;

* modifies estimated tax rules for closely-held REITS;

* modifies the rules applicable to certain corporate tax avoidance transactions by changing certain standards;

* requires consistent treatment and provides basis allocation rules for transfers of intangibles in certain non-recognition transactions; and

* prohibits allocation of stock in an S Corporation ESOP.

— Sunset Requirements —

H.R. 2488 sunsets all tax reductions outlined in the measure after 2009 (although certain provisions sunset after 2008). Specifically, only the following tax provisions sunset in 2008. They include the (1) individual income tax rate reductions; (2) marriage penalty tax relief; (3) AMT repeal for individuals; (4) most capital gains tax provisions; and (5) additional IRA catch up contributions for individuals aged 50 and over.

Other Information:

For information on H.R. 2488 as it was debated in the House, see *Legislative Digest*, Vol. XXVIII, #19, Pt. II, July 19, 1999; and #23, Pt. IV, August 4, 1999.

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